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GERMANY'S REPARATION PAYMENTS—DISCUSSION

JOHN H. WILLIAMS.—It is a great privilege to be permitted in this company to discuss the paper of my former teacher, Professor Taussig, to whom I am chiefly indebted for the inspiration and direction of my own interest in international trade. Professor Taussig's forecast of the effects upon international trade of the German reparation payments is illuminating, and full of suggestions for the inductive studies that will need to be made of this greatest of all experiments in international finance. I need scarcely say that in his main conclusions I agree entirely with Professor Taussig, and that such comment as I shall make will be mostly in the nature of elaboration of certain points which I find especially interesting.

Professor Taussig's paper deals in the main with three related topics, which I shall treat in the following order: first, the form in which the reparation payments will be made; second, the direction which they will take; and third, the mechanism whereby they will work out their effects upon international trade.

I agree entirely with Professor Taussig's conclusion that the payments must take the form of goods and result in an excess of German exports over imports; that any borrowing of capital to which Germany might resort would be of but temporary effect and only serve to increase the ultimate payments in goods; and that at the conclusion of the reparation payments, and not until then, the excess of exports, so far as due to the reparation payments, must disappear.

I should like to add a word, however, concerning the amount of the excess of exports while the payments are being made, and the probable situation after the payments have ceased. Professor Taussig puts the excess of exports at about \$750,000,000, or the amount of the annual indemnity. And regarding the situation after the conclusion of the reparation payments, he says that, in accordance with the Ricardian analysis, the consequent back-flow of specie and the resulting changes in price levels will lead finally to a "stage of equilibrium identical with that which prevailed at the very start."

Both of these statements, of course, represent an intentional simplification of complex phenomena, for the sake of theoretical exposition. It scarcely needs to be said that the amount of the excess of exports will depend in part upon the extent of the other "invisible" items in the German post-war balance of international payments. In the five years, 1909-13, the German trade balance showed an excess of imports over exports, averaging \$352,201,000 a year. About \$200,000,000 of this represented the earnings of interest on German capital invested abroad, and about \$50,000,000 represented shipping earnings, the remainder being divided among such other credit items as earnings of German banks and commercial houses abroad, tourists' expenditures in Germany, and the like. It is true that the year has removed the chief of these German credits,—all of her shipping, and certainly the greater part of her foreign investments, so that, aside from the

reparation payments, the exports and imports of Germany in the post-war period might be expected to come more nearly to an equality than before the war. Yet even at the beginning of this new period these other items will not be wholly absent, and as time goes on they may be expected to assume greater and greater importance. *Some* lending and borrowing, for example, there will surely be. Also, the shipping item will stand at the beginning of the period as a debit; Germany will need to export more than she imports in order to cover the expense of ocean carriage in foreign vessels. Later on, there will in all likelihood be a revival of the German merchant marine. When we consider that the prewar German merchant fleet of over 5,000,000 gross tons was created almost entirely in the quarter of a century following 1890, it is to be expected that in the next quarter of a century, under the added economic pressure and the psychological influence of a rapidly expanding export trade, the re-creation of the German merchant marine will be even more rapid, and that the shipping item will again pass to the credit side of the German balance of payments. To the extent that this change occurs, it will tend to cut down the excess of exports over imports.

Concerning neither the amount of the excess of exports at any given time, therefore, nor its varying extent throughout the period of the reparation payments, can one make any definite statement beyond the indubitable fact that payments so large as those called for by the reparation program are sure to constitute the dominating factor in the balance of payments.

The second statement quoted, namely, that the cessation of the reparation payments will lead, theoretically, to a "stage of equilibrium identical with that which prevailed at the very start," arouses in me misgivings which I have entertained for a couple of years past. I am skeptical of the reality of "stages of equilibrium" in international trade at all, not to speak of the possibility of a return, after the period of a generation, to an identical past stage of equilibrium. In my own studies of international balances I have not come upon anything which I recognized as a stage of equilibrium. Always there is unceasing change in the volume or direction of the numerous items making up the balance of payments. What one finds is a series of overlapping changes, working sometimes in the same direction, sometimes at cross-purposes, but never settling down to a stage of equilibrium. Some of the changes stand out with such prominence, so dominate the balance of payments for a period of years, as to render possible the quantitative study of their effects,—as, for example, the great outburst of borrowings in Argentina, culminating in the Baring panic of 1890, or the similar outburst preceding the panic of 1873 in our own country, or that which in a few years of war has altered our own international position from debtor to creditor.

Especially is the notion of a stage of equilibrium inapplicable to a country which, like Germany, is on a basis of depreciated paper money. An inconvertible paper situation is by its very nature one of insta-

bility. Every change in the balance of international payments effects a change in the value of the paper currency, and every change in the value of the currency in turn sets in motion forces which react upon the trade balance; and this process is unceasing whenever and so long as paper is depreciated below par with gold, and is not freely convertible into gold at a fixed rate of exchange. My own study of the Argentine balance of payments during the paper money régime, which terminated in 1899, has convinced me that in an inconvertible paper money situation a state of equilibrium is an impossibility.

This reasoning from artificially simplified stages of equilibrium through periods of transition to new stages of equilibrium is a characteristic product of the Ricardian mode of thought,—with its insistence upon abstraction from change and its love of mathematical precision. As a methodological device for theoretical exposition it is useful and perhaps necessary. In applying it to so complex a situation as that which will arise when Germany, a country with depreciated paper currency, undertakes to pay some \$750,000,000 of annual indemnity, one needs to be keenly aware of its limitations, above all of its extremely artificial simplicity and preciseness.

Professor Taussig's second proposition relates to the direction which the excess of exports occasioned by the reparation payments is likely to take; and his conclusion is that Russia offers the only considerable outlet for German trade expansion. Russia will need manufactures and Germany agricultural products. The same factors which made the Germans so powerful an influence in Russia before the war,—the fact of proximity coupled with the German powers of organized commercial penetration,—may be expected to exploit this basic condition favoring trade to its utmost, and without loss of time. Very likely, as before the war, the dominant merchant class in western Russia will again be German. In a recent article, Professor Goldstein, of the University of Moscow, shows by statistical tables to what an increasing extent Germany has dominated Russian import trade since 1896; and warns the Allies against a renewal of the German domination.

The situation is not altogether clear, however. As is usually the case, other factors are likely to work at cross-purposes with the observed tendency. One of these factors is the probable effect of Russian borrowing operations. Russia, as a "young country," rich in natural resources but poor in capital, will be for a long period a borrower of capital,—once she convinces the outside world of her financial integrity. If it is true, as Professor Taussig predicts (and I think rightly), that Germany will be unable to resume the gold standard for an extended period, it is not to be expected that she will be in a position to lend. Russia will turn for loans to other countries. The countries best prepared to lend will undoubtedly be the United States and Great Britain. The borrowings will take the form of goods,—construction materials, machinery, manufactures of various sorts; and past experience has shown that these goods, the direct product of loans, are most likely to be purchased in the country making the loans.

Prewar German and British trade show very distinctly this connection between foreign investment and foreign trade. Particularly has this been the case in their relations with Latin American countries, in whose foreign trade I have been especially interested. In part, the imports to Russia will come as a *direct* result of the borrowing, without giving rise to foreign exchange operations, and in part as the *indirect* result, through the effects of the borrowings on foreign exchange rates, gold movements, and alterations in price levels, in accordance with the Ricardian analysis. By reason of Russian borrowing, therefore, we may expect to find England and our own country competitors with Germany in the Russian import trade. In other words, we have here a factor whose effect, though favoring an expansion of Russian imports, would be to limit and interfere with the expansion of the German export trade with Russia.

There is a second factor which, according to theory, may be expected to limit the expansion of German exports to Russia, though in a directly contrary manner from that just mentioned. Russia, like Germany, is on a depreciated paper money basis. As Professor Taussig has said, a depreciating paper currency operates as a powerful stimulus to exports and as a discouragement to imports. Viewing this factor alone, one would expect an expansion of Russian exports, and a curtailment of imports, a "favorable" balance of trade, as in the case of Germany herself:—a set of circumstances by no means favorable to an expansion of German, or any other, exports to Russia.

With regard to the other possible outlets for German exports, I do not share Professor Taussig's opinion concerning the probable future of the German export trade with Latin America. It is true that the British have done their utmost to oust German firms, and to break down the machinery for financing German trade; and it is true that the United States has gone farther forward in Latin American trade in the last five years than in any generation previous thereto; yet my own observations in Argentina two years ago, and in Guatemala this past summer, lead me to believe that the reports of the extent to which the elimination of German interests has been carried are much exaggerated. In the countries which remained neutral, of which Argentina and Chile are the chief, the German banks, exporting and importing houses, industrial and agricultural enterprises are virtually intact. Moreover, even in the countries which declared war, the confiscation of German properties did not go so far as is generally supposed, only the properties of Germans resident in Germany being confiscated. I heard in Argentina, as late as 1918, more than one frank avowal of preference for German goods. During the war the large German exporting houses in Buenos Aires were buying stocks of raw materials for shipment to Germany at the close of the war. Since the Armistice Germany has sent to Argentina a special commissioner, who has successfully negotiated for colonization lands for German immigrants; and Argentina has advanced credits to Germany for the purchase of Argentine food products and raw materials. American commercial

representatives returning from Latin America are already bringing the story of German activity for a revival of her Latin American trade. In view of facts of this sort, my belief is that German export trade to Latin America is capable of fairly rapid revival and extension, if German export prices are favorable to such an expansion.

I come now to Professor Taussig's third topic,—the mechanism whereby the reparation payments will work out their effects upon international trade.

As Professor Taussig has explained, the peculiarity of the case is that Germany is, and will be for some time, on a basis of depreciated paper money. How explain alterations in exports and imports resulting from the reparation payments, when the usual mechanism of gold points, gold movements, and their resulting effects upon the price levels of the trading countries are absent? This intricate problem obviously could not be discussed at any length in a brief paper of which it is only a part; so that Professor Taussig has contented himself with a brief general statement. At the suggestion of Professor Taussig, I spent about a year in Argentina studying its balance of payments under the depreciated paper régime, which lasted from 1885 to 1899; and I should like to point out one or two important differences between the paper money mechanism as I found it there to have been at work, and Professor Taussig's present exposition.

Professor Taussig says that in the Ricardian analysis for gold countries, foreign exchange rates, the gold premium, and the general level of prices move in precise accord; whereas in paper money countries foreign exchange rates and the gold premium move together, but diverge widely from general prices, the resulting gap offering a bounty to exporters and imposing an added burden on importers, thus bringing about an increase of exports and a diminution of imports. "The divergence is especially wide for domestic commodities," he says. "It is less so for international goods; yet it is considerable and lasts long for the international goods also." He thus makes it clear that the bounty to exports consists in the gap between the premium on gold (that is, the rate of foreign exchange) and the prices of these international goods.

It seems to me that both of these statements require qualification: (1) that there is a necessary correspondence between the rate of exchange and the gold premium; (2) that there is a gap between the gold premium and general prices (or more narrowly, between the gold premium and the price level of international goods), and that it is this gap which operates as a bounty to exports, and a discouragement to imports.

Regarding the first statement, there is no inherent reason why the gold premium and the rate of exchange should correspond. The fact of their correspondence depends entirely upon whether the exchange mechanism is a paper mechanism or a gold mechanism. If foreign exchange is bought with depreciated paper, then the price of exchange, giving title to foreign gold money, is itself the gold premium,—that is,

the measure of the value of the domestic paper in terms of the international standard money, gold. It is entirely possible, however, in a paper money country to maintain a gold standard of foreign exchange, at the same time that the domestic paper currency is depreciated below a par with gold. Such a gold exchange was actually maintained in Argentina throughout the entire period of depreciated paper money. Persons engaged in foreign trade maintained a gold account, as well as a paper account, with their bankers, and bought foreign exchange only with gold, which they purchased in the open market with paper. Under such a system, there are gold points and international gold movements of precisely the same sort as in any gold standard country.

The point I wish to make, therefore, is that the correspondence between foreign exchange rates and the gold premium, and the gap between these and the general price level, are not the essential features of the explanation of trade changes in paper money countries. The essential fact is, that, whatever the mechanism of exchange in the paper money country, gold can not enter into the monetary circulation, and can not, therefore, bring about those changes in price levels which form the crux of the usual explanation of trade changes. On the contrary, just the opposite price changes are brought about. Whereas in a gold country an increased demand for exchange raises the rate, induces an outflow of gold, and thus *lowers* the price level; in a paper money country such an increase of demand for exchange, by requiring more of the domestic paper to be given for the title to foreign gold, depreciates the paper still further, and thus *raises* the price level. This would be the first effect in Germany of such a heavy demand for exchange as that which would be caused by the payment of \$750,000,-000 a year of indemnity.

How, then, with this precisely opposite effect in the price level, explain the *same* effect on the foreign trade as would be brought about in a gold standard country,—namely, an increase of exports?

Professor Taussig's explanation is that the increased demand for exchange would cause a gap between the rate of foreign exchange and the general level of prices, so that exporters could buy cheaply in Germany, sell their products abroad, and dispose of the resultant bills of exchange to marked advantage. My own investigation supports a somewhat different explanation. It finds the stimulus to exports, not in the gap between foreign exchange rates and the general price level, but in the different effects of a depreciating paper money on different sets of prices, all of which form a part of the general price level. Stated more definitely, exports are stimulated because of the different effects of depreciating paper money on the selling prices of exports and their cost of production.

Except in rare instances, where a nation produces so great a part of the world supply of a product as to dominate the world market (as in the case of our own cotton, or of Brazilian coffee), one nation can not ordinarily determine international prices. It can only accept the international price, and determine the amount of product it will export

at that given price. An exporter in Germany, therefore, in buying goods for foreign consumption, would base his price on the international *gold* price of the commodity, the cost of freight to the foreign country, and the premium on gold. In other words, given the foreign gold price minus cost of transportation to the foreign market, he would convert this price into German paper marks at the current rate of exchange. Given free competition, his export price thus becomes a paper money reflection of the international gold price. Abstracting from fluctuations in the foreign gold price, it is thus apparent that German export prices would keep pace exactly with the rise in the premium on gold, and in fact be identical with it. My study of Argentine export prices for the fifteen years, 1884-99, shows this correspondence with the fluctuations of the gold premium to a striking degree. On the other hand, it shows that wages, rents, and other costs of production do not rise so rapidly as export prices. It is this gap, between export prices and exporters' costs of production, and not, as has been stated, a gap between the rate of exchange (that is, the gold premium) and the general price level,—or between the rate of exchange and the price of international goods,—which gives an extra profit, or "bounty," to the exporter, and thus causes exports to expand.

DITLEW M. FREDERIKSEN.—I would like to add a couple of illustrations, suggested by the address by my former teacher, Professor Taussig, as to how the payment of the German indemnity will work out.

One is suggested by the experience of my native country, Denmark, whose foreign trade twenty years ago was almost entirely triangular. The Danes purchased their manufactures from Germany, and sold their agricultural, dairy, and packing-house products to England. Lately they have been selling more to Germany, but this export trade will evidently be cut off, as Germany, owing the indemnity, will not be able herself to consume these agricultural products, but will continue to export manufactured goods to Denmark, and Denmark in return will send food products to England and other allied countries.

The cheap German manufactured goods will stimulate Danish agriculture, and Danish agricultural products will compete in European markets with, for instance, those from the United States and Canada.

The same will be true of Russia; the same will be true of the South American republics. It would seem that so large an amount as six hundred million dollars a year will have a far-reaching effect upon the price of agricultural products, and will work to stimulate agriculture in all our competitors, Denmark, Russia, the Argentine, etc.

The packers probably will not suffer; they will themselves go to the Argentine and sell Argentine products on the Atlantic seaboard, but it would seem that the payment of the German indemnity will hit the agriculture of the entire Northwest and Canada in a most unexpected way, as the cheap German manufactured products will stimulate agriculture in all these countries, and enable them to undersell us abroad

and to some extent possibly even at home. This applies of course both to the United States and Canada.

The only way I see in which our farmers can protect themselves against this tidal wave of foreign competition will be to let the bars down so that some of these cheap German manufactured goods can enter here, and this seems to me the only way in which we can hope to keep our markets for agricultural exports against the tidal wave of foreign competition that will be mounting against us.

I think it a most interesting suggestion that the German indemnity will be paid largely in Russian and Argentine agricultural products, and I can see no escape from the conclusion that the indemnity reaching so large an amount will have a far-reaching effect on our entire foreign commerce, and also upon agricultural conditions at home.